



The UK's Financial Services Act 2012: Some Key Features

In the late 1990s, the UK Financial Services Authority (the "FSA") was created by Gordon Brown, the incumbent-Chancellor of the Exchequer, combining a number of regulatory authorities into a single body to oversee the UK's financial services industry. Together with the Bank of England and the Treasury, the FSA formed part of a tripartite system of regulation to ensure financial stability. In the financial crisis, the tripartite system proved ineffective in this regard. Therefore, 15 years later, April 1, 2013 saw the start of a new regulatory landscape in the UK as the majority of the reform provisions contained in the Financial Services Act 2012 (the "FS Act") were implemented.¹

The FSA has been abolished and there have been created three new financial regulators. In addition, certain new powers have been granted to the new regulators to assist them in identifying, preventing and, if necessary, responding quickly to financial stability issues in the future.²

Regulatory Structural Changes

The Financial Conduct Authority

The Financial Conduct Authority ("FCA") is the organisation that has taken over the legal status of the FSA and a significant portion of its previous functions. The FCA is therefore the UK regulator responsible for the business conduct of all firms previously regulated by the FSA, including those firms also subject to additional prudential supervision by the Prudential Regulatory Authority ("PRA") (see below). In addition, the FCA also acts as the prudential regulator of all firms other than those subject to PRA regulation. This includes insurance intermediaries, personal investment firms, mortgage intermediaries and other firms not considered 'systemically important'. The FCA also regulates firms providing market services (such as recognised investment exchanges and providers of multilateral trading facilities) and addresses conduct issues in the market more generally.

The objective of the FCA is to ensure that business across the financial services industry and markets is conducted in a manner that furthers the interests of market participants and consumers.

The Prudential Regulation Authority

The PRA, a subsidiary of the Bank of England (the "BoE"), is responsible for micro-prudential regulation of the largest firms considered 'systemically important' to the UK economy and markets. Examples of these entities include banks, insurers and certain large investment firms. These 'PRA-authorized firms' are known as 'dual-

¹ Financial Services Act 2012 – <http://www.legislation.gov.uk/ukpga/2012/21/contents/enacted>.

² For details of the consultation paper leading to the Financial Services Act 2012, see client alert *UK Treasury Consultation on the New Financial Regulatory Structure in the UK* dated August 3, 2010 – <http://www.mofo.com/files/Uploads/Images/100803UKTreasury.pdf>.

regulated firms' since, in addition to the PRA regulation of prudential issues, the FCA will remain as their business conduct regulator.

The general objective of the PRA is to promote the safety and soundness of regulated firms. The PRA will implement policies to ensure that firms carry on their business in a way that avoids adverse effects on the financial system and attempt to minimise any wider effects of a firm's failure. The PRA has operational independence from the BoE in respect of its day-to-day supervision, with a focus on setting institution-specific capital requirements.

The Financial Policy Committee

The FPC is a committee of the BoE and is responsible for macro-prudential regulation of the UK financial industry. In order to satisfy this responsibility, the committee considers prudential regulation issues across the entire UK financial system, looking at the general risks to the economy and analysing emerging trends or asset bubbles in order to prevent problems arising. The broad focus of the FPC contrasts with that of the PRA, which targets supervision of individual firms at a micro level. Unlike both the PRA and FCA, the FPC does not have direct regulatory responsibility for any particular types of firm or specific entities.

The FPC's overall objective is to assist the BoE in achieving financial stability by identifying, monitoring and taking action to remove or reduce systemic risks. For this purpose, 'systemic risk' is risk to the stability of the UK financial system as a whole or to a significant part of that system. The FPC implements its measures through the PRA and FCA, who are responsible for applying the identified measures directly to applicable regulated firms.

Although the FPC was formally established in statute from April 1, 2013, an interim FPC has been in operation from February 2011.

Additional Powers of the Regulators

Product intervention powers of the FCA³

A new power available to the FCA will be the ability to implement product intervention rules. In exercising this power, it has been made clear that the FCA will intervene at an earlier stage and have a lower risk tolerance than the FSA, in order to ensure an appropriate degree of consumer protection. This allows the FCA to introduce temporary rules barring or restricting the sales of certain products or services. In creating these rules, the FCA is not required to consult or prepare cost/benefit analysis, although any product intervention rules instigated by the FCA must be temporary, ceasing to have effect within 12 months of the day on which they come into force and may not be renewed. In general, the new powers enable the FCA to:

- make temporary product intervention rules having immediate effect, where the FCA considers it 'necessary or expedient' to meet its consumer protection or competition objectives. Actions could include blocking the launch of a product or prohibiting the sale or distribution of an existing product to a particular type of investor, or altogether. The FCA is not currently permitted to make product intervention rules for market integrity reasons, although these may become eligible grounds for such action in the future, if the Treasury makes a further order in this respect; and
- make rules regarding the unenforceability of contracts made in breach of product intervention rules. Potential rules could include stipulations that such contracts are void and consumers are entitled to recover payments made under them.

³ For more detail on the UK product intervention regime, see client alert *Product Intervention in the UK and the New FCA* dated July 5, 2011 – <http://www.mofo.com/files/Uploads/Images/110705-Product-Intervention-in-the-UK-and-the-New-FCA.pdf> and Structured Thoughts Volume 4, Issue 5, *FCA Temporary Product Intervention Rules: Nipping it in the Bud* – <http://www.mofo.com/files/Uploads/Images/130412-Structured-Thoughts.pdf>.

Extension of the special resolution regime

The FS Act also extends the ability of the relevant authorities, *i.e.* the PRA, the FCA and the Treasury, to place 'systemically important' entities under the 'special resolution regime' (the "SRR"). The SRR currently provides a mechanism to allow the authorities to resolve failing banks or building societies, in cases where failure is imminent and the other powers of the regulatory authorities are insufficient to minimise the effect on the economy in general.⁴

Following the implementation of the FS Act, the Banking Act 2009 will be amended to bring the following entities under the scope of the SRR if deemed 'systemically important':

- 1) **Investment firms:** Certain investment firms will now come under the scope of the SRR, although if not considered systemically important, the firm would remain subject to the existing Special Administration Regime. The objective is to protect client assets and minimise adverse effects on the operations of the financial market infrastructure.
- 2) **Group companies of investment firms and deposit-taking entities:** Due to the perceived risk that financial and mixed holding companies in a group structure might undermine the effective application of the SRR, the SRR will apply to banking group companies. This application is limited to groups where the business of the holding company, or its subsidiaries, consists primarily of financial services and will be applied at the level of the parent undertaking to minimise the impact on other non-financial business undertaken.
- 3) **Central counterparty clearing houses ("CCPs"):** As a stop-gap measure until other expected EU legislation is introduced, CCPs incorporated in the UK have been added to the list of entities which can be made subject to the SRR. The objective of applying the SRR to CCPs would be to minimise the adverse effects on the broader financial system of a CCP failure, and the most important objective of the SRR in respect of CCPs would be preserving the continuity of the CCP's payment and delivery obligations.

Regulation of benchmark-related activities

The FS Act and supporting secondary legislation introduce recommendations made by the Wheatley Review⁵ on the regulation of benchmark-related activities. This was an independent investigation established after a number of major banks entered into settlement agreements with international regulators regarding the provision of inaccurate submissions for the London Interbank Offered Rate ("LIBOR") benchmark. LIBOR will initially be the only relevant benchmark for the purposes of the newly created provisions, although the FS Act allows for additional benchmarks to be added to the scope on a future date. These provisions, which came into force on 2 April 2013, are summarised below.

New criminal offence of manipulation of a benchmark

The FS Act replaces the existing market manipulation provisions in the Financial Services and Markets Act 2000 and creates the new criminal offence of 'making false or misleading statements or creating a false or misleading impression in relation to specified benchmarks'. This offence is punishable by imprisonment for a term not exceeding seven years (six months in the case of a summary conviction) and/or a fine.

⁴ For more detail on the special resolution regime, see client alert *Update on UK Government's Banking Support Measures and the Banking Act 2009* dated March 30, 2009 – <http://www.mofo.com/files/Publication/a0b55b63-3800-4b35-981a-5b771a19c6ca/Presentation/PublicationAttachment/Ofdb6b63-c456-48f2-b98b-66b30728a482/090330UKBank.pdf>.

⁵ The Wheatley Review of LIBOR, final report – http://cdn.hm-treasury.gov.uk/wheatley_review_libor_finalreport_280912.pdf.

Regulated activities relating to benchmarks

Further, the FS Act has introduced two new regulated activities subject to supervision by, and authorisation from, the FCA (with prudential supervision from the PRA if applicable):

- **Providing information in relation to a specified benchmark:** This covers any provision of information or expression of opinion that is (i) given to, or intended to be passed to, a person who administers a benchmark, regarding that benchmark; (ii) required in connection with the determination of a benchmark; or (iii) provided for the purpose of the determination of a benchmark. Certain information subscription services provided to benchmark administrators are excluded from this activity.
- **Administering a specified benchmark:** This includes (i) administering the arrangements for determining a benchmark; (ii) collecting, analysing or processing information or expressions of opinion for the purpose of determining a benchmark; or (iii) determining a benchmark through the application of a formula or other method of calculation to information or expressions of opinion provided for that purpose. The FCA is excluded from the authorisation requirement in case it is required to administer a benchmark in the future to protect the financial system generally.

The FCA's new rules governing these regulated activities now form a new MAR 8 section of the Market Conduct Sourcebook.⁶ In general, these rules will require increased monitoring and oversight action to identify misleading behaviour. Additionally, participating entities are expected to minimise conflicts of interest arising between benchmark submitters and other areas of the business and prevent undue influence on benchmark submitters from senior management.

Practical implications of the Financial Services Act 2012 for firms

Since the UK Treasury announced the proposed changes to the regulatory regime in June 2010, steps have been taken to try to ensure that there is minimal disruption during the implementation. However, some practical implications for firms may be:

- Firms that are already regulated by the FSA will be "grandfathered" into the new regime and will not need to reapply to the FCA or the PRA for their authorisations and regulatory approvals. Firms for whom the FCA is their prudential regulator will have a similar relationship with the FCA as they do at present with the FSA. PRA-authorized firms, however, will need to adapt to supervision by two regulators and manage the impact of regulatory processes, such as the approved persons regime, being split between two regulators. Further, for these firms, the current FSA ARROW risk mitigation programme will be replaced by two separate programmes with two sets of mitigating actions to address.
- In respect of the new product intervention powers, although reasonable endeavours will be made to ensure that information about any new rules that may be introduced is communicated as widely as possible, the FCA does not actually commit to contacting affected market participants to notify them of such rules. The temporary rules will be published on the FCA website and included in the FCA Handbook when implemented, and although it is expected that the FCA will enter into additional forms of communication, firms should have adequate systems in place to keep track of these rules and ensure they act in compliance with them.
- A number of transitional provisions have been introduced to make the change to benchmark regulation an easier process. Any bank that is currently a LIBOR submitter is deemed to have permission to continue providing that benchmark information following April 1, 2013. Similar transitional provisions apply to current benchmark administrators.

⁶ FCA Market Conduct Sourcebook - <http://fsahandbook.info/FSA/html/handbook/MAR>.

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